2024

# Private Equity Secondaries

## Secondary Strategy in Private Equity

The secondary strategy in Private Equity involves the buying and selling of stakes in existing Private Equity funds. Essentially, this strategy provides an additional tool for portfolio construction by allowing investors to sell their stakes in funds at various stages of the fund's lifecycle and enabling new investors to purchase stakes in funds that are already underway.

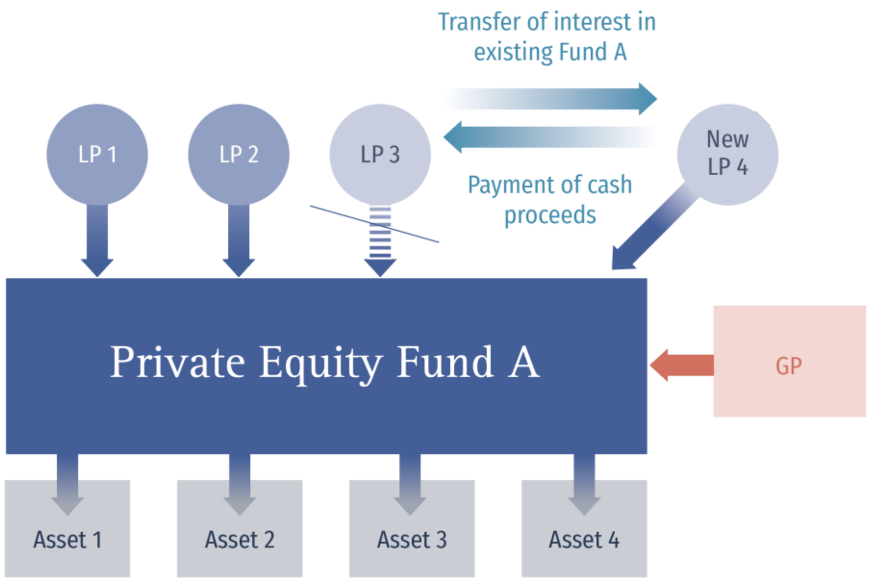
There are two main types of transactions in the secondary Private Equity market: those offered by investors in private equity funds ("LP-Led transactions") and those offered by fund managers ("GP-led transactions").

## LP-Led transactions

LP stands for "Limited Partner," which is the legal term used in English to refer to fund investors. In LP-Led transactions, investors decide to sell their stakes to other market investors.

*Simplified example:*

You invested in a Private Equity fund and now want to sell your position to another investor. The other investor buys your position and becomes the new LP of this fund.




## Why would an investor sell their position in a fund?

There are several reasons why an investor might choose to sell their position in a fund. Some examples include:

1. **Liquidity:** The investor might need money immediately for other investment opportunities, personal expenses, or to address financial emergencies.

2. **Portfolio Rebalancing:** The investor decides to reduce exposure to a particular fund due to regulatory reasons, risk perception, diversification, or a change in strategy.

3. **Opportunity Cost:** A new investment opportunity might arise that the investor considers more advantageous than maintaining the current position in the fund.

4. **Tax Planning:** The investor might be looking to optimize their tax situation by taking advantage of deductions or avoiding higher future taxes.

5. **Organizational Changes:** Shifts such as changes in leadership, revisions in allocation policy, or strategic realignment might lead an institution to reassess its investments.

6. **Personal Changes:** Changes in personal life, such as retirement, health changes, or asset transfers to heirs or beneficiaries, might lead the investor to reassess their investments.

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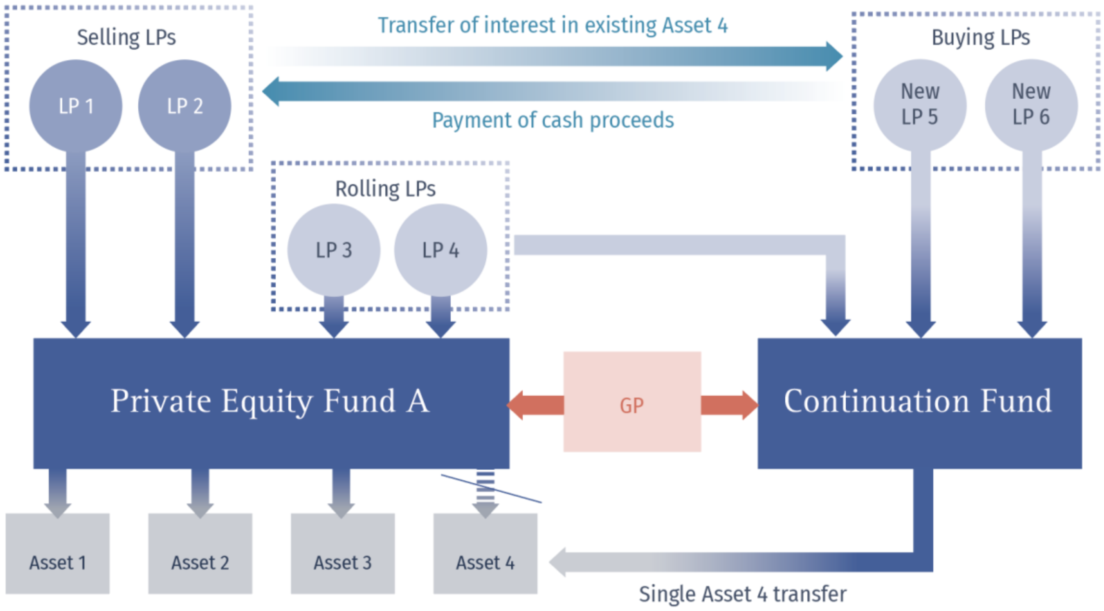
## What are GP-Led transactions?

GP stands for "General Partner," which is the legal term used in English to refer to the fund manager. These transactions are led by fund managers and involve the restructuring, recapitalization, or sale of companies in their portfolio.




*Simplified example:*

A fund manager has a private equity fund with a 10-year investment term. As the tenth-year approaches, the manager identifies that one or more assets in the fund still have significant growth potential if managed for another 5 years. To continue managing this asset and simultaneously return capital to investors at the end of the original term, the manager can structure a new vehicle specifically for this asset, commonly called a "continuation vehicle." In this case, the asset is transferred to the continuation vehicle, new terms and conditions are defined, and the original fund investors face two options:

*(a) sell their stake to new investors interested in the continuation vehicle; or*

*(b) transfer their stake from the original fund to the new fund and continue investing in the asset under the new conditions set by the manager in the continuation vehicle.*

This structure allows the manager to continue managing the asset for a longer period, enhancing its value while offering investors the flexibility to choose between immediate liquidity or remaining invested with future return prospects.

## Why would a manager transfer an asset to a new fund?

**1. More upside in the investment:** The fund might be nearing the end of its life, but the GP believes some assets still have significant appreciation potential.

**2. Few exit options for companies:** In certain market cycles, M&A activity might be weak, and the IPO window closed, making it difficult to sell assets at prices the manager deems adequate and fair for their portfolio companies.

**3. Avoid transferring a trophy asset to competitors:** A common exit channel for companies in a fund is selling assets to another private equity manager, a type of sale known as "sponsor-to-sponsor." Structuring a continuation vehicle is a strategy adopted by GPs to avoid selling their top-performing company to a competing GP, only to see that company potentially generate two to three times the returns after their original investment.

**4. Liquidity for investors:** Original LPs might be looking for an early exit from their investments.

**5. Portfolio optimization:** The GP might identify that certain assets no longer align with the fund's investment strategy but can still generate returns with a different risk profile.

Know more about secondaries